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In the Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Eleventh Circuit

BRIEF OF BANKRUPTCY LAW PROFESSORS ROBERT M. LAWLESS, BRUCE A. MARKELL, AND JOHN A. E. POTTOW AS *AMICI CURIAE* IN SUPPORT OF AFFIRMANCE

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QUESTION PRESENTED

Should *Dewsnup v. Timm*, 502 U.S. 410 (1992), be extended to exempt a completely underwater second mortgage from lien avoidance under section 506(d) of the Bankruptcy Code?

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are three leading scholars of bankruptcy, commercial, and business law who have been teaching, researching, and writing about bankruptcy law for decades. They seek to provide the Court with a fuller description of the legal rules, history, and policies affected by this case.

Robert M. Lawless is the Max L. Rowe Professor at the University of Illinois College of Law and is an elected member of the American Law Institute, a conferee of the National Bankruptcy Conference, and a fellow of the American College of Bankruptcy. He is also co-author of a leading casebook on secured credit.

Bruce A. Markell is a former bankruptcy judge and currently the Jeffrey Stoops Professor of Law at Florida State University and co-author of four casebooks in bankruptcy, contracts, secured transactions, and securitization. He is a member of the Board of Editors of *Collier on Bankruptcy*, and an elected member of the American Law Institute, a conferee of the National Bankruptcy Conference, and a fellow of the American College of Bankruptcy, where he currently serves as its Scholar in Residence.

John A. E. Pottow is the John Philip Dawson Collegiate Professor of Law at the University of Michigan Law School, a member of the International

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[1] Respondents have filed with this Court a blanket consent to *amicus* briefs. Petitioner has furnished a written consent to the filing of this brief, and a copy of that consent has been filed with this Court concurrently with the filing of this brief. No counsel for a party authored any part of this brief. No person, other than *amici* and their counsel, has made a monetary contribution toward the preparation or submission of this brief.

Insolvency Institute, and a co-author of a leading textbook on bankruptcy law.

SUMMARY OF ARGUMENT

When debtors can't pay their bills, state law allows their creditors to grab their assets in an uncoordinated and chaotic manner. What few assets there are go to the swift, while the uninformed and cautious take nothing. This process destroys asset value, which not only hurts debtors, but the debtors' other creditors as well. Congress enacted the Bankruptcy Code to address this imbalance and potential for waste. Through its operation, the Code seeks to maximize returns to *all* creditors, not just the aggressive, and to offer debtors a better chance to pay their debts and rehabilitate their finances.

To achieve these goals, the Code treats secured creditors and unsecured creditors differently. Secured creditors are those whose loans to the debtor come with collateral. In the event the debtor cannot repay the debt, the secured creditor can look to that property for repayment. A mortgage provides exactly this kind of secured claim. If the debtor defaults on the debt, the secured creditor (mortgagee) can secure payment on the debt by foreclosing on the debtor's home. Unsecured creditors, on the other hand, don't have this option. They are paid only if anything is left after the secured creditors have liquidated their collateral. The Code's entire apparatus is designed to ensure fairness in dividing the debtor's property among these secured and unsecured creditors.

In this case, Bank of America wants to turn that careful balance upside down. The bank asks this Court to create a valuable asset that the market and the Code

regard as worthless. The bank is a junior lienholder on an underwater mortgage, meaning that the value of the home does not even cover the secured claim of the senior creditor. The Code's plain language treats junior lienholders in this situation, like Bank of America, as unsecured creditors. 11 U.S.C. § 506(a).

Bank of America asks this Court to redefine the nature of its claim. The bank wants its lien to be an "allowed secured claim," *id.*, that survives the bankruptcy process. The only conceivable reason for seeking such legal alchemy is so the bank can extract value from the debtor and other creditors by impeding the orderly financial resolution that the Code is specifically designed to provide. The bank argues that the Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), compels this result.

The U.S. Court of Appeals for the Eleventh Circuit disagreed, concluding that *Dewsnup* did not apply. *In re Toledo-Cardona*, 556 F App'x 911, 912 (11th Cir. 2014) (unpublished opinion). *Dewsnup* held that in cases where the value of the underlying home covers some but not all of a lien, the undersecured creditor can still retain its legal claim on the property after bankruptcy. Creditors whose liens are completely devoid of value, the lower court held, cannot receive the same treatment. *Id.* (following *Folendore v. U.S. Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989)).

Bankruptcy law scholars Robert M. Lawless, Bruce A. Markell, and John A. E. Pottow, file this brief to urge the Court to affirm the lower court's sensible conclusion. They explain why Bank of America's arguments are inconsistent with the Code's plain language, history, and fundamental policies.

To reverse the reasoning of the judgment below—that holders of mere allowed unsecured claims cannot bootstrap into becoming treated as secured creditors—would subvert essential elements of the Code's basic architecture, namely: (1) enforcing the secured creditor's bargain that it must look to the value of the collateral for repayment, (2) ensuring equal treatment of all unsecured creditors, (3) minimizing the potential for holdout and hostage value to derail voluntary debt adjustments inside and outside bankruptcy, and (4) in consumer cases, according debtors finality in resolving their financial distress and a fresh start through discharge. *Dewsnup* should not be extended to bring about this result. Alternatively, *Dewsnup* should be overruled outright as a long-overdue error correction in bankruptcy jurisprudence.

ARGUMENT

I. The Bankruptcy Code Already Provides More Benefits to Junior Creditors Than They Would Receive Under State Law

A. Bank of America's Lien Under State Law Is Worthless

Bank of America holds a junior lien against Respondent Caulkett's home. Because the value of his home has fallen substantially since the loan was issued, the value of the junior lien is zero. The home's value isn't even enough to pay back Caulkett's senior creditor. If that senior creditor foreclosed on the house tomorrow in response to Caulkett's default, Bank of America would receive nothing. More importantly, the senior creditor's decision to foreclose would wipe out Bank of America's lien, forever extinguishing its (worthless) claim on the collateral. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.1. (1997).

Bank of America knows this. Because "the present value of the collateral is less than the amount outstanding on senior mortgages, if the houses were sold today, Bank of America would obtain no recovery." Pet. Br. 26. But the bank and its supporting *amici* argue that affirming the lower court somehow presents Caulkett a windfall that deprives the bank its due.[2] The bank argues that the Code requires it to retain its lien and hopes that the market correction that rendered its lien worthless

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[2] The "windfall" argument only applies to an individual debtor; a corporate debtor—such as a commercial real estate owner—can never have a windfall because it gets no discharge in liquidation. 11 U.S.C. § 727(a)(1).

will somehow, some day, correct itself sufficiently for the bank to recoup some of its investment. In the meantime, the bank's worthless lien should continue to cloud the property's title, preventing the senior lienholder and Caulkett from reaching any settlement.[3]

State law cuts off Bank of America's desire to play the market. Under state law, junior lienholders get nothing if a foreclosed property's sale price leaves a senior creditor undercompensated. This is why junior lienholders charge much higher interest rates. The benefit of the bargain for junior lienholders like Bank of America is that in exchange for charging more for the second mortgage, the junior lienholder has a higher risk of ending up without a security interest in the property in the event it is wiped out at foreclosure. Under state law, a junior lienholder is subject to the whims of the market, and, perhaps more importantly, the control of the senior lienholder. If the debtor defaults under the senior lien, the senior lender has a categorical right to foreclose; the junior lender has no say in the matter.

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[3] The Loan Syndications and Trading Association (LSTA), *amicus* in support of Bank of America, contends in passing that these liens are not economically worthless because there is "a secondary market" where LSTA members "frequently purchase debt" that is "often secured by a secondary lien." Brief for Loan Syndications and Trade Association at 1. *Amici* law professors do not dispute that there are secondary debt markets; *amici* argue only that there is no evidence that there is a market for *underwater* liens, the kind at dispute in this case. Worthless loans—without "value" in the parlance of the Code—might conceivably trade in some jurisdictions where they have been sanctioned, but they could only trade in the majority of others (where they have not been sanctioned) by only the most risk-tolerant speculators willing to take the chance their liens will not be avoidable under a binding judicial interpretation of section 506(d).

Even if the junior lienholder feels that a foreclosure occurs during an inopportune dip in the housing market, there is no recourse under state law. Once the senior lienholder forecloses, the junior lien is gone, and title is cleansed.

B. The Code Already Protects Bank of America's Junior Lien

Bank of America and its *amici* argue that affirming the lower court's decision would somehow use bankruptcy to deprive Bank of America of its legal property rights created under state law. This claim is mystifying, because the Code is much more generous to underwater junior lienholders than applicable state foreclosure law discussed above.

The key lies in the valuation of the collateral. Under state law, value is determined subject to the mechanistic process for foreclosure, where the junior lienholder has effectively no input in the process. Not so in bankruptcy. To value the junior lienholder's interest, the debtor must bring a motion, and the bankruptcy judge will perform a valuation that avoids the often punishing fire sale valuations that occur in foreclosures. Fed. R. Bankr. P. 3012. This bankruptcy valuation process can include expert testimony and provides ample space for a junior lienholder to argue that a forced liquidation would undervalue the home, and that the "true" value would render part of the secondary lien secured for purposes of the Code. *Id.*

In other words, although section 506—the section at issue in this case—separates secured from unsecured claims, the process by which those claims are separated differs dramatically from the regimented strictures of state law. The parties in bankruptcy court, including the

junior lienholder, can litigate their claims in a way that the foreclosure process does not accommodate. Individualized judicial valuation hearings in bankruptcy give the junior lender a much fairer shot at capturing any value than a state-law foreclosure.

Bank of America thus can already protect itself through the bankruptcy valuation process if it believes the market is undervaluing its underwater lien. And in fact, if it believes the bankruptcy valuation process itself is insufficient, it can go further. It can purchase an asset that it believes the market and the bankruptcy court have both undervalued by offering to buy it in bankruptcy for more than the determined aggregate value of the allowed secured claims. 11 U.S.C. § 363(f). Any trustee would jump at the deal.

But, of course, acquiring real estate is risky. Prices go down as well as up. And here is the essential problem of Bank of America's position: it wants this Court to allow it access to a risk-free investment. If the price goes up, it still has its nondischargeable lien. If it goes down, the trustee or the debtor—not Bank of America—takes the hit. What the junior lienholder could not secure in the market, and what it could not secure through the bankruptcy valuation process, it wants to receive by rewriting the Code.

A fundamental principle of bankruptcy law is that the Code should not alter state law entitlements absent a necessary bankruptcy law purpose. *See Butner v. United States*, 440 U.S. 48 (1979) (refusing to craft a special rule for mortgagees in bankruptcy to give them a right to rents they do not have under state law). According a free option to a junior lienholder does not just deviate from state law, it is antithetical to the purposes of bankruptcy law.

II. Bank of America Asks the Court to Grant It "Hostage Value" for Its Otherwise Worthless Liens

One might wonder why an underwater second lienholder would fight to protect a worthless lien. The answer is not in the lien's intrinsic market value, which is zero. Instead, it lies in indirect value. Even a worthless lien can allow its holder to derive some value from the property. This is the lien's "hostage value," which is both economically inefficient and inconsistent with the aims of the Code.

A leading secured credit casebook clarifies the distinction between market value and hostage value. "The usefulness of property as collateral will ultimately depend on (1) how much value the creditor can extract from it after default (will it bring anything at resale?), and (2) how much leverage the creditor can derive from its ability to deprive the debtor of the property (how much will the debtor be willing and able to pay to keep it?)." Lynn M. LoPucki & Elizabeth Warren, SECURED CREDIT 22-23 (7th ed. 2012). As explained above, the first factor in this case has already been determined: zero. Bank of America and all other junior lienholders on underwater properties must therefore rely on this second factor—the lien's ability to make the debtor or other creditors buy its holder off to clean title to the property.

This second type of value is called a property's "hostage" or "holdout value." *See* Anthony T. Kronman, *Contract Law and the State of Nature*, 1 J. L. ECON & ORG. 5, 15-18 (1985). Many secondary liens provide their holders substantial hostage value over homeowners and their primary creditors notwithstanding the lack of market value. Homeowners face real costs associated

with the disruptions of losing their homes, such as moving expenses and employment relocation, and so will pay a ransom to avoid these costs. The sentimental attachment many homeowners have to their homes would only magnify the effect of this distortion.

The ability of a secondary lienholder to force a foreclosure, post-bankruptcy—*even though a successful foreclosure will bring it absolutely no economic benefit*—enables it to extract payment from a homeowner who wants to prevent that foreclosure. In a sense, the junior lienholder on an underwater mortgage is simply playing an expensive game of chicken. The disproportionate value that homeowners attach to staying in their homes is exactly the target for these junior lienholders. Such lienholders, who don't really want to incur the costs of foreclosure, are simply hoping the homeowner will blink first.

The debtor's other creditors also suffer from the worthless liens that remain attached to a property, clouding the property's title and stymieing alternative arrangements between the senior lienholder and the homeowner. *See generally* Vicki Been, Howell Jackson, & Mark Willis, *Sticky Seconds—The Problems Second Liens Pose to the Resolution of Distressed Mortgages*, 9 N.Y.U. J.L. & BUS. 71 (2012) (discussing underwater junior lienholders' pernicious role in workouts). This reality stems from the fact that even the most worthless junior lien can prevent deeds in lieu of foreclosure and short sales—two commonly used mechanisms to reach out-of-court resolutions of distressed mortgages—from taking place.

A deed in lieu of foreclosure allows a homeowner (the mortgagor) to convey property to its lender in full satisfaction of the debt without going to court. That is,

the homeowner turns over the keys (and the deed), and the lender no longer seeks to recover from the loan. If a home is worth less than the senior mortgage, a deed in lieu of foreclosure can be an efficient, cost-effective method for satisfying the senior lender and relinquishing the debtor's claim to title. But the deed in lieu of foreclosure is essentially a private transaction between borrower and lender and as such cannot eliminate other liens on the property besides the one held by the primary lender. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 8.5 cmt. B (1997). Although a junior lienholder can get nothing and have its lien erased in a formal foreclosure, it can still prevent the easier option of an out-of-court deed in lieu of foreclosure simply by saying "no" (or, more accurately, demanding a payment to say "yes").

Similarly, a short sale occurs when the lender agrees that the homeowner can sell the property to a third party for less than the amount owing on the mortgage free of the lender's claim. In short sales, the lender avoids the delay and costs of foreclosure and gets the market price the short-sale purchaser is willing to pay. The homeowner gains a complete or partial release from any deficiency, and title to the property is again cleared. But here, as with deeds in lieu of foreclosure, the junior lienholder can prevent a short sale entirely. The result is that the junior lienholder can extract payment from either the senior lienholder or the debtor to facilitate the short sale by threatening to prevent this expedited disposition of the underwater home by refusing to convey clean title to the purchaser.

Thus, the underwater junior lienholder acts as a sort of nuisance plaintiff who files a frivolous claim and must be bought off by the senior creditor if the costs of

requiring full foreclosure instead of deeds in lieu of foreclosure, short sales, or even refinancings with the debtor exceed the payoff demanded by the gadfly to go away. Exploitation of this hostage value harms both debtors and senior lenders alike. Both suffer rent extractions to junior lienholders that the Code is designed to prevent.[4]

One reason the Code evinces such hostility toward hostage value is the multi-party nature of bankruptcy proceedings. Consider a commercial firm with vital machinery that has been tailored to its own purposes. On a secondary market, this machinery will have little value. But if the debtor loses its machinery, it loses much more than the resale value. It may indeed lose the value of the entire enterprise. A lienholder could extract an extravagant premium from the debtor to prevent repossession and concomitant factory shutdown.

Outside bankruptcy, that hostage value is simply unpleasant for the debtor—simply a product of the contracting parties' negotiation. If the debtor grants a lien on the specialized machinery to get cheap credit, so be it. But in bankruptcy, the threat of hostage value is devastating. Every dollar a debtor pays to satisfy a lienholder's hostage value is a dollar that does not go to pay other creditors. The Code aims to neutralize, even eliminate, these kinds of zero-sum contests. For exactly this reason, the Code mostly protects only the "objective" value of the collateral itself, not the hostage

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[4] *Hostage value* is the liquidation bankruptcy cousin to the bane of reorganization bankruptcy: *holdout value*. The Code combats that related economic impediment to bankruptcy goals by allowing the vote of a creditor class to bind all class members to a reorganization plan. *See* 11 U.S.C. §§ 1126(c), 1129.

value premium of a "subjective" excess. Section 1129(b)(2)(A), for example, allows secured creditors to receive the "value of [the secured creditor's] interest" in the debtor's property, not the subjective value of the asset to the debtor. *See also* 11 U.S.C. § 1225(a)(5)(B) (secured creditor receives the amount of the "allowed secured claim"); *id.* § 1325(a)(5)(B) (same). Doing so carefully balances the rights of secured creditors with all other claimants in the debtor's estate.

III. This Court's Precedents Do Not Support the View that "Liens Pass Through Bankruptcy"

A. Liens Do *Not* Pass Through Bankruptcy; They Pass Through Bankruptcy Only if the Code Permits Them to Stay in Place

Bank of America argues that it is entitled to its economically disruptive, inefficient, and atextual reading of the Code because of a supposedly overarching and ancient principle of bankruptcy law that "liens, including underwater liens, ride through chapter 7 bankruptcy unaffected." Pet. Br. 44. For support, it cites the Court's decision in *Dewsnup*, 502 U.S. at 417-18.

Although *Dewsnup* announced its understanding of historical practice as favoring a policy that allowed liens to survive bankruptcy, *id.* at 418, this conclusion is only partially true and dangerously misleading, especially so when quoted as a general aphorism.

In fact, liens are altered, capped, subordinated, and even wholly avoided in bankruptcy proceedings all the time. The list of Code provisions that alters liens is dizzying. The automatic stay of section 362 stops a secured creditor from enforcing its lien, and the secured creditor is not compensated for the delay in realizing on

its collateral. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1992). Under section 364(d), a bankruptcy court can under some circumstances award a lender who lends to the debtor after the filing of the bankruptcy petition a "superpriority" lien that trumps existing liens on property of the estate. A lien can be avoided as a preference under section 547 or a fraudulent transfer under section 548. Section 522(f) allows debtors to avoid some liens that impair exemptions on certain assets. The trustee might avoid a lien under the "strong-arm powers" of section 544. The trustee can avoid some statutory liens under section 545. These provisions apply generally to all bankruptcy debtors, regardless of the chapter under which they have filed a petition. The list goes on.

Additionally, in a chapter 11 reorganization plan, a secured creditor can be crammed down and have its lien altered over its objection. If a cramdown happens to a secured creditor, that creditor receives the value of its collateral, not the full amount of its lien. *See* 11 U.S.C. § 1129(b)(2)(A). Similarly, the baseline rule in chapters 12 and 13 is that secured creditors receive only the value of their collateral, 11 U.S.C. §§ 1225(a)(5)(B)(ii), 1325(a)(5)(B)(ii). Where Congress wanted to depart from that baseline rule it wrote specific exceptions. *See* 11 U.S.C. §§ 1322(b)(2), 1325(a) (unnumbered paragraph) (requiring payment of full *allowed* claim, not capped valuation at *allowed secured* claim, for some debts owed on primary residences and new cars). It is also incorrect that a creditor can stand aloof from a bankruptcy proceeding and have its liens survive unscathed. Section 501(c) allows the bankruptcy trustee or the debtor to file a proof of claim on behalf of a creditor who does not file one, lien or no lien.

Thus, the misleading "liens ride through bankruptcy" half-truth invoked in *Dewsnup* and pushed by Bank of America here might be more correctly reformulated as "liens ride through bankruptcy *unless affected by the Bankruptcy Code.*" *Cf. In re Pence*, 905 F.2d 1107, 1109 (7th Cir. 1990) ("These cases actually stand for nothing more than the proposition, now codified in 11 U.S.C. § 506(d), that unless action is taken to avoid a lien, it passes through a bankruptcy proceeding.") Reduced to this proper form, the saying devolves into tautology.

Nonetheless, the tautology provides insight into places where the Code is silent. *Amici* do not dispute the idea that the Code leaves liens in place unless a provision of the statute operates otherwise. In other words, if the Code does not independently adjust the rights of a lienholder, the bankruptcy process leaves those rights untouched. But beyond that general statement of how to treat silence in the Code, the slogan "liens ride through bankruptcy" does not help answer questions such as the one at issue in this appeal. The contest here is precisely whether section 506(d) is one of those many instances where the Code alters liens. Bank of America's misleading incantation that "liens ride through bankruptcy" skips the very analysis that the bank is asking this Court to perform.

B. This Court's Key "Liens Ride Through" Precedent—*Long v. Bullard*—Does Not Actually Hold that Liens Ride Through Bankruptcy

Not only is the naked statement that "liens ride through bankruptcy" misleading on its face, it stems from a misunderstanding of the case usually invoked as the venerable authority for the proposition, *Long v.*

Bullard, 117 U.S. 617 (1886). *See* Pet. Br. 23, 28, 31, and 35. A careful review of the facts of that case clarifies that the primary legal issues involved the interaction between state property law and federal bankruptcy law.

Long, a debtor, had claimed a homestead exemption in his federal bankruptcy proceeding and argued that that exemption defeated a state law mortgage. All this Court held was that claiming the homestead exemption under federal bankruptcy law did not act to eliminate the mortgage on the underlying real estate. *Id.* at 621. The question the Court decided was only whether the debtor's right to claim a homestead exemption in bankruptcy somehow invalidated the lien the creditor claimed as a mortgage. The Court announced no broad principle of liens and bankruptcy law. (Tellingly, the aphoristic phrase appears nowhere in the opinion.) On the contrary, the case was chiefly concerned with federalism and issue preclusion in determining the validity of the mortgage.

Without detouring too deeply into the facts of a 130-year-old case, the main issue in *Long* arose more from the idiosyncratic nature of the mortgage in question than it did from sweeping principles of bankruptcy law. Creditor Bullard loaned money at usurious rates to debtor Long, secured by a deed to Long's house. Long then went through bankruptcy and discharged his debts. When Bullard later came to foreclose on the mortgage, Long successfully challenged Bullard's underlying loan as usurious and therefore invalid under state law, requiring the mortgage to be set aside. Bullard countered that at the time of the original loan, an equitable mortgage arose to the extent the loan was non-usurious. The state courts agreed with Bullard. *Bullard v. Long*, 68 Ga. 821 (1882).

In this Court, the case became one about the ability of the federal courts to revisit state-law determinations regarding when the equitable mortgage arose under state law. Because the state courts had decided the mortgage arose at the time of the original loan, this Court concluded that there was no space for federal courts to say otherwise. As Chief Justice Waite concluded: "*The dispute . was as to the existence of the lien at the time of the commencement of the proceedings in bankruptcy.* That depended entirely on the state laws, as to which the judgment of the state court is final and not subject to review here." *Long*, *117* U.S. at 620-21 (emphasis added). The case was not a solemn pronouncement of the general treatment of liens under federal bankruptcy law, as the subsequent mythology appears to have it. Instead, the parties were litigating the boundary lines between state and federal law in bankruptcy. The Court's conclusion that it was bound to respect state courts' determinations of the existence and timing of state-law property rights had nothing to do with broad principles of bankruptcy.

Long v. Bullard is often associated with the notion that "liens ride through bankruptcy." This is legal mythology. Like the children's game of broken telephone, the idea has been repeated so many times that its original meaning has long been lost. The actual holding of *Long v. Bullard* is much narrower than the half-truth that "liens ride through bankruptcy."

C. Liens Have Always Been Subject to Alteration in Bankruptcy.

Amici for Bank of America include the erroneous recitation of the *Long v. Bullard* mythology. See Brief for Loan Syndications and Trading Association at 12-16

("LSTA Brief"). But those *amici* seem to make another historical argument: independent of *Long*, the principle that liens cannot be violated in bankruptcy has been a constant principle of federal bankruptcy law.

This is incorrect. There are of course cases holding that particular facts do not trigger lien-avoiding provisions of the Code. Again, *amici* here agree with *amici* for Bank of America that the bankruptcy discharge does not, without more, erase an otherwise legal lien. LSTA Brief at 12, 16. The extensive history cited in the LSTA Brief demonstrates precisely this view that all parties can endorse. Liens *sometimes* survive bankruptcy, except when they do not.

But this proposition is obvious and unhelpful. Despite the historical examples offered by LSTA, previous versions of the bankruptcy law routinely allowed courts to avoid liens for reasons "other than payment on the debt." *Dewsnup*, 502 U.S. at 418-19. For example, section 14 of the Bankruptcy Act of 1867 allowed the avoidance of any judicial lien obtained within four months of the bankruptcy. Bankruptcy Act of Mar. 2, 1867, ch. 176, 14 Stat. 517 § 14 (repealed 1878) ("1867 Act"). Section 67 of the Bankruptcy Act of 1898 did much the same thing. Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544, § 67 (repealed 1978). Under these laws, creditors who obtained liens as an impermissible preference did not survive bankruptcy. Similarly, liens that were obtained for less than reasonably equivalent value have been avoidable as fraudulent transfers. *See, e.g., id.*

The most that can be said regarding the historical practice of liens in bankruptcy under prior statutes was that provisions expressly protecting liens were included in the Bankruptcy Acts of 1800 and 1841. And the

Bankruptcy Act of 1867 allowed for protection outside the four-month window mentioned above. *See* Bankruptcy Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 § 63 (repealed 1803); Bankruptcy Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 § 2 (repealed 1843); 1867 Act § 14. To that limited extent, then, it is true that some liens under some prior versions of the federal bankruptcy law "rode through" bankruptcy by explicit congressional command. But at that level of generality, the proposition is unremarkable.

D. Whether Liens Sometimes Rode Through Bankruptcy Is Ultimately Irrelevant

All this historical discussion reduces to two general points: (1) liens sometimes rode through bankruptcy under prior, repealed versions of the bankruptcy laws, and (2) sometimes they did not under those same laws. But it is a strange argument to insist that 200-year-old statutes, since abrogated in their entirety by an intentionally comprehensive overhaul of the bankruptcy system, should count as anything other than a historical curiosity.

To decide whether Congress's innovations to the rights of secured creditors were intentional or inadvertent in 1978 should require focus on what *that* Congress, not prior Congresses, said. And there, the House Judiciary Committee's report explained the reasons for the changes in section 506, and is worth quoting in full.

> One of the more significant changes [wrought by the Bankruptcy Code] is the treatment of secured creditors and secured claims. The distinction becomes important in the handling of

> creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors who are undersecured.
>
> . . . .
>
> Throughout the bill, references to secured claims are only to the claim determined to be secured [under Section 506(a)], and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their place "secured claim" and "unsecured claim."

H.R. Rep. No. 95-595, at 180-81, 356.

The opinion in *Dewsnup* mistakenly contends there is no evidence in the "annals of Congress," 502 U.S. at 420, that section 506 was meant to deviate from the opinion's understanding of bankruptcy history. But the opinion did not cite that history, even as other, pre-*Dewsnup* circuit courts had done. *See In re Lewis*, 875 F 2d 53, 55 (3d Cir. 1989); *In re Ahlers*, 794 F 2d 388, 394 n.5 (8th Cir. 1986), *rev'd on other grounds*, 485 U.S. 197 (1988). The existence of the committee report's clear explanation of congressional intent behind section 506 further undercuts *Dewsnup*'s claim that Congress was inadvertently abrogating a historical practice of lien protection in bankruptcy law.[5]

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[5] *Amici* appreciate that the Court believed the historical bankruptcy practice illuminating in *Dewsnup*, 502 U.S. at 418-19, but the brief discussion there (relied upon heavily by Bank of America) oversimplified the history. As just discussed, provisions of pre-Code law frequently invalidated liens for reasons other than payment. *But see id.* ("Apart from reorganization proceedings, *see*

(Continued...)

IV. This Court Should Overrule *Dewsnup*

Amici believe that *Dewsnup* need not be overruled to affirm the judgment below. In *Dewsnup*, the lien in question still had market value: it was merely worth less than the debt owed on the lien. At least in those factual circumstances, an undersecured creditor retains the incentive to reach out-of-bankruptcy settlement. But, as argued above, liens such as Bank of America's that retain no market value give the holder no incentive to do anything but impede the orderly resolution of a homeowner's financial distress. Thus, *amici* urge the Court to uphold the lower court's decision.

A cleaner way, however, for the Court to reach the same result would be to overrule *Dewsnup* once and for all and return the plain meaning to the text of section 506(d) that *Dewsnup* upended. Whether this case presents the best vehicle to do so is something on which *amici* express no opinion. *Amici* are certain, though, that the opinion is deeply flawed and should be abandoned.

Dewsnup is a short and thinly-theorized precedent that almost no bankruptcy scholar defends. The principal problem is one of statutory interpretation. The opinion is almost completely irreconcilable with the plain language of the Code and effectively concedes as much.

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11 U.S.C. §§ 616(1) and (10) (1976 ed.), no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt."). And, *Long v. Bullard* was about much more than the bankruptcy discharge's effect on liens. *But see id.* at 419 ("In *Long v. Bullard*, 117 U.S. 617, 620–621 (1886), the Court held that a discharge in bankruptcy does not release real estate of the debtor from the lien of a mortgage created by him before the bankruptcy.").

Id. at 417 ("Were we writing on a clean slate, we might be inclined to agree with petitioner that the words 'allowed secured claim' must take the same meaning in §506(d) as in § 506(a)"). This tension has led to the widespread—near-unanimous—criticism of that opinion by bankruptcy scholars. *See, e.g.*, David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 Am. Bankr. L.J. 1, 16 (1996) (characterizing *Dewsnup*'s assignment of different meanings to "allowed secured claim" in §§506(a) and (d) as "overt interpretive violence"); Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 Mich. L. Rev. 2234 (1997) ("*Dewsnup* was not only a historical anomaly in terms of the Supreme Court's established methodology in its approach to bankruptcy cases, but also an untenable exception in the ever-more-clearly emerging course of bankruptcy jurisprudence under the Code.").

As a matter of textual interpretation, *Dewsnup* could most charitably be described as problematic. Section 506(d) provides, in relevant part, that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." 11 U.S.C. § 506(d). The Court in *Dewsnup* read "allowed secured claim"—an expressly defined term of art in the Code—to mean "allowed claim." *Dewsnup*, 502 U.S. at 417–18.[6]

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[6] *Dewsnup* attempted to redefine "allowed secured claim" in section 506(d) as, effectively, "allowed claim that is at least in some part secured." An undersecured creditor's full allowed claim would thus meet this definition, as it is both allowed and, to some extent, secured.

(Continued...)

By so doing, the Court excised one of the most important words in the Code from this section. In bankruptcy, most everything hangs on whether a creditor holds (or does not hold) a security interest. It is one thing to read the same term in different parts of a lengthy statute differently. It is quite another to do so *within the very same statutory section in which it is defined*, as Justices Scalia and Souter forcefully observed in dissent. *See Dewsnap*, 502 U.S. at 422 (Scalia, J., dissenting) (observing the rule that identical words used in different parts of the same statute take the same meaning "must surely apply, *a fortiori*, to use of identical words *in the same section of the same enactment.*")

Dewsnup's error is not confined to section 506(d). Rather, it destabilizes section 506(a)'s definition of "allowed secured claim" in a way that casts doubt on the vitality of its meaning. It is supposed to be a "term of art," *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993), that is used "throughout the Code," H.R. Rep. No. 95-595 at 356. *Dewsnup*'s rewriting of "allowed secured claim" in one part of the Code means its

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The problem with this special reading of "allowed secured claim" is that section 506(d) is a provision that specifically voids liens. Voiding liens can only apply to secured claims, because there is no such thing as a lien on an unsecured claim. By definition, an unsecured claim is a debt *unsecured by a lien*.

Dewsnup's reading of section 506(d) to restrict lien avoidance on liens that satisfy its two prongs—(1) allowed, and (2) to some extent, secured—thus contains a redundant second prong, which means the test collapses into the first prong only: liens are not avoided on allowed claims. Thus, *Dewsnup* presents a textual conundrum of reading "allowed secured claim" as "allowed claim," a concession Bank of America is forced to make. Pet. Br. at 19.

meaning in other sections is up for grabs for lenders and debtors to litigate and bankruptcy, district, and appellate courts to redefine with no burden of consistency. Such uncertainty and inconsistency are anathema to the spirit and letter of uniformity that Congress wrought in the passage of the Code for the hundreds of thousands of bankruptcy petitions adjudicated annually. "The risks of relying on such practice in interpreting the Bankruptcy Code, which seeks to bring an entire area of law under a single, coherent statutory umbrella, are especially weighty." *Bank of America National Trust & Sav. Ass'n v. 203 North LaSalle Street P'ship*, 526 U.S. 434, 461 (1999) (Thomas, J., concurring).

Dewsnup has been subsequently criticized by members of the Court as committing "methodological error" in laying the grounds for this uncertainty. *Id.* at 461; *see also id.* at 463 ("Regrettably, subsequent decisions in the lower courts have borne out the dissenters' fears. The methodological confusion created by *Dewsnup* has enshrouded both the Courts of Appeals and, even more tellingly, Bankruptcy Courts, which must interpret the Code on a daily basis.") This uncertainty lingers over the Code today and will continue to do so until this Court abandons *Dewsnup*'s faulty reasoning.

Amici are mindful of the doctrine of *stare decisis*, and do not seek to portray themselves as experts thereon. Whether this is the right vehicle to overrule *Dewsnup*, or whether an overruling should be given only prospective effect to future creditors, are questions that

likely exceed our areas of expertise.[7] *Amici* note nothing more than the fact that this Court can and does overrule statutory precedents when appropriate circumstances arise. *See, e.g., Hubbard v. United States*, 514 U.S. 695 (1995) (overturning previous statutory interpretation and returning to the plain textual meaning). To the extent helpful to the Court's analysis, *amici* advise from their perspective as bankruptcy experts that the *Dewsnup* opinion is uniformly criticized, generally wreaks havoc with the Code by injecting unwarranted uncertainty, and is unlikely to have generated any serious reliance interests by secured creditors according to the best available empirical evidence.

* * *

Bank of America and other underwater junior lienholders charge higher interest rates for their risky investments. But they are not completely without recourse in the event that their risky security becomes worthless: the bankruptcy process allows them to participate in the valuation of the property and, if necessary, share in the estate as unsecured creditors.

What the bank now seeks, though, is something else, something new: hostage value that will disrupt the bankruptcy process and wreak havoc on debtors and

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[7] There is only one *stare decisis* point *amici* wish to address specifically. Bank of America contends congressional inaction demonstrates acquiescence to *Dewsnup*. Pet. Br. 41. *Amici* think this is unfair. Because the Court itself admitted it was contravening the fairest reading of the text of section 506(d), it's not clear how Congress should have amended that text, other than adding "i.e., as just defined in subsection (a)," right after "allowed secured claim," which would be a startling drafting requirement.

creditors alike. The Court should reject Bank of America's breathtaking suggestion that hostage value is a central and time-honored policy of the Code. Reversing the lower court would create an asset that gives comfort only to those creditors who seek to shake down debtors and senior creditors for a payment that neither the market nor the Code would permit. This Court should not play along with Bank of America's attempt to enjoy a leg up over other creditors and get a risk-free investment at the expense of the bankruptcy process.

CONCLUSION

For the foregoing reasons, the decision of the court of appeals should be affirmed.

Respectfully submitted,

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